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INTRODUCTION

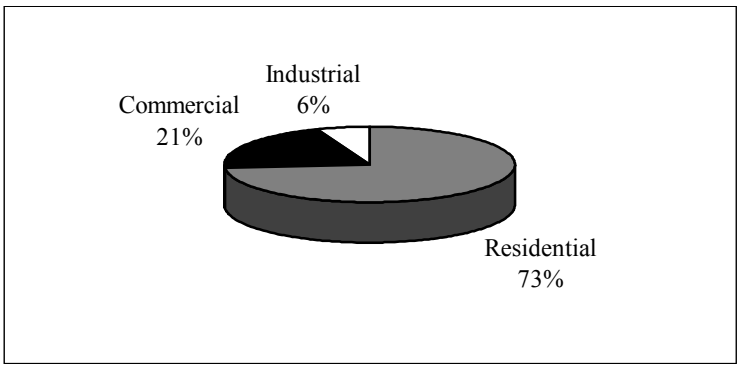
In accordance with the City Auditor's 1997-98 Audit Workplan, we audited the City of San Jose's sewer billing services. This is the first report in a series of audits of the Sewer Service and Use Charge Fund and the sewer services that the Environmental Services Department (ESD) provides. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor's Office thanks the Administrative Services, Environmental Enforcement, and Technical Support Divisions of the ESD, and the Billing Services and Revenue Collection Units of the Treasury Division of the Finance Department for their time, information, insight and cooperation during the audit.

BACKGROUND

The City of San Jose's (City) Sewer Service and Use Charge (SSUC) Fees are designed to charge users of sewer services in proportion to the benefit they receive. There are three broad categories of users including approximately 194,400 residential locations, 9,400 commercial and light industrial locations, and 50 monitored industrial locations. The Proposed 1998-99 Operating Budget includes approximately $68.8 million in SSUC Fees. This includes $50.6 million in fees from residential users, $14.2 million from commercial and light industrial users, and $4 million from monitored industrial users. Graph I shows that residential users are the largest of the three categories.

GRAPH I
PROPOSED 1998-99 SEWER SERVICE AND USE CHARGES



Residential Users

The City bills residential sewer users $227.52 per year for single-family residences, and $130.20 per unit for multiple-family residences and mobile homes. The Santa Clara County Tax Collector's Office places these service charges on the property tax rolls and collects SSUC Fees from property owners. The Billing Services Unit (Billing Services) of the Treasury Division of the Finance Department (Treasury) is responsible for maintaining current information about all residential sewer accounts.

Commercial And Light Industrial Users

Commercial and light industrial sewer customers are those customers who discharge sewage of uniform strength or discharge less than 25,000 gallons per day. The rate structure for these customers is based on the difference in sewage strength using 21 standard classifications of users. Billing Services estimates annual water consumption for each user by annualizing water consumption for the months of January, February and March of the previous fiscal year extended for the following year. The City of San Jose Municipal Code specifies these months to minimize the effects of landscape and garden irrigation. Billing Services calculates the annual charge for each sewer account. Table I shows the commercial and light industrial rates.

TABLE I
COMMERCIAL AND LIGHT INDUSTRIAL RATES

USER CLASSIFICATION	CHARGE PER HUNDRED CUBIC FEET OF SEWAGE DISCHARGED
Wineries	$ 4.41
Paper pulp mills	3.34
Restaurants	3.07
Automotive steam cleaners	3.06
Dairy product processors	2.99
Wholesale bakeries	2.55
Soft drink bottlers	2.52
Machinery manufacturers	2.28
Printing plants	2.20
Meat packers	2.10
Schools, colleges and universities	1.95
Repair shops and service stations	1.90
Hotels/motels	1.86
Hospitals and convalescent homes	1.81
Electrical equipment	1.72
Retail, commercial office	1.72
Domestic laundries	1.71
Film service laboratories	1.69
Car washes	1.61
Plating works	1.55
Soft water services	1.55

Billing Services places the above service charges on the Santa Clara County property tax rolls. The Santa Clara County Tax Collector collects the service charges from property owners and remits the amount collected to the City.

Monitored Industrial Users

Non-residential users discharging more than 25,000 gallons of sewage per day or discharging sewage of widely varying strength, are billed monthly on the basis of samples collected during the billing period. The SSUC Fees for monitored industrial uses are billed in two parts – SSUC Monthly Operations and Maintenance Cost Recovery Fees and annual SSUC Capital Cost Recovery Fees. The SSUC Monthly Operations And Maintenance Cost Recovery Fees for monitored industrial users by flow, biochemical oxygen demand (BOD), suspended solids (SS), and ammonia (NH3) are shown in Table II.

TABLE II
SSUC MONTHLY OPERATIONS AND MAINTENANCE COST RECOVERY FEES FOR MONITORED INDUSTRIES 1997-98

COMPONENT	FEE
Flow	$1.3786 per hundred cubic feet
BOD	$0.098 per pound
SS	$0.123 per pound
NH3	$0.95 per pound

Monitored industrial users also pay annual SSUC Capital Cost Recovery Fees based on peak flow and loadings during the year. The Administrative Services Division of the ESD bills these monitored industrial users for their annual SSUC Capital Cost Recovery Fee on a monthly basis. The SSUC Capital Cost Recovery Fees are shown in Table III.

TABLE III
ANNUAL SSUC CAPITAL COST RECOVERY FEES
FOR MONITORED INDUSTRIES
1997-98

COMPONENT	FEE
Flow	$35,289 per million gallons per day (estimated peak daily flow) OR $17,645 per million gallons per day (estimated peak daily flow) for dry seasonal peak users whose peak flows are July-September
BOD	$11,060 per thousand pounds per day (estimated peak daily concentration)
SS	$11,503 per thousand pounds per day (estimated peak daily concentration)
NH3	$26,189 per thousand pounds per day (estimated peak daily concentration)

The Environmental Enforcement Division of the ESD is responsible for monitoring sewer flow and taking periodic sewage samples from monitored companies. The Laboratory in the Technical Support Division of the ESD tests the samples for concentrations of billable substances (BOD, SS, and NH3), and forwards the results to the Administrative Services Division of the ESD. The Administrative Services Division is responsible for collecting flow information from water providers, estimating water loss adjustments, tabulating self-reported company data and data from the Technical Support Division, calculating billing amounts, and preparing monthly invoices for the approximately 50 monitored industries. The Treasury Division of the Finance Department is responsible for collection of the amounts due.

Administrative Services Division Of The ESD

Chart I shows the organization of the Administrative Services Division of the ESD including the Administrative Fiscal Services Unit (Fiscal Services). Fiscal Services is responsible for the revenue program of which monitored industrial user SSUC Fees are a part. Specifically, Fiscal Services collects the billing information and prepares the bills. The Source Control Unit of the Environmental Enforcement Division (see Chart II) is

responsible for regulating industrial discharges to the Water Pollution Control Plant. The Source Control Unit inspects monitored locations and collects the laboratory samples that the Technical Support Division processes.

CHART I
ADMINISTRATIVE SERVICES ORGANIZATION CHART

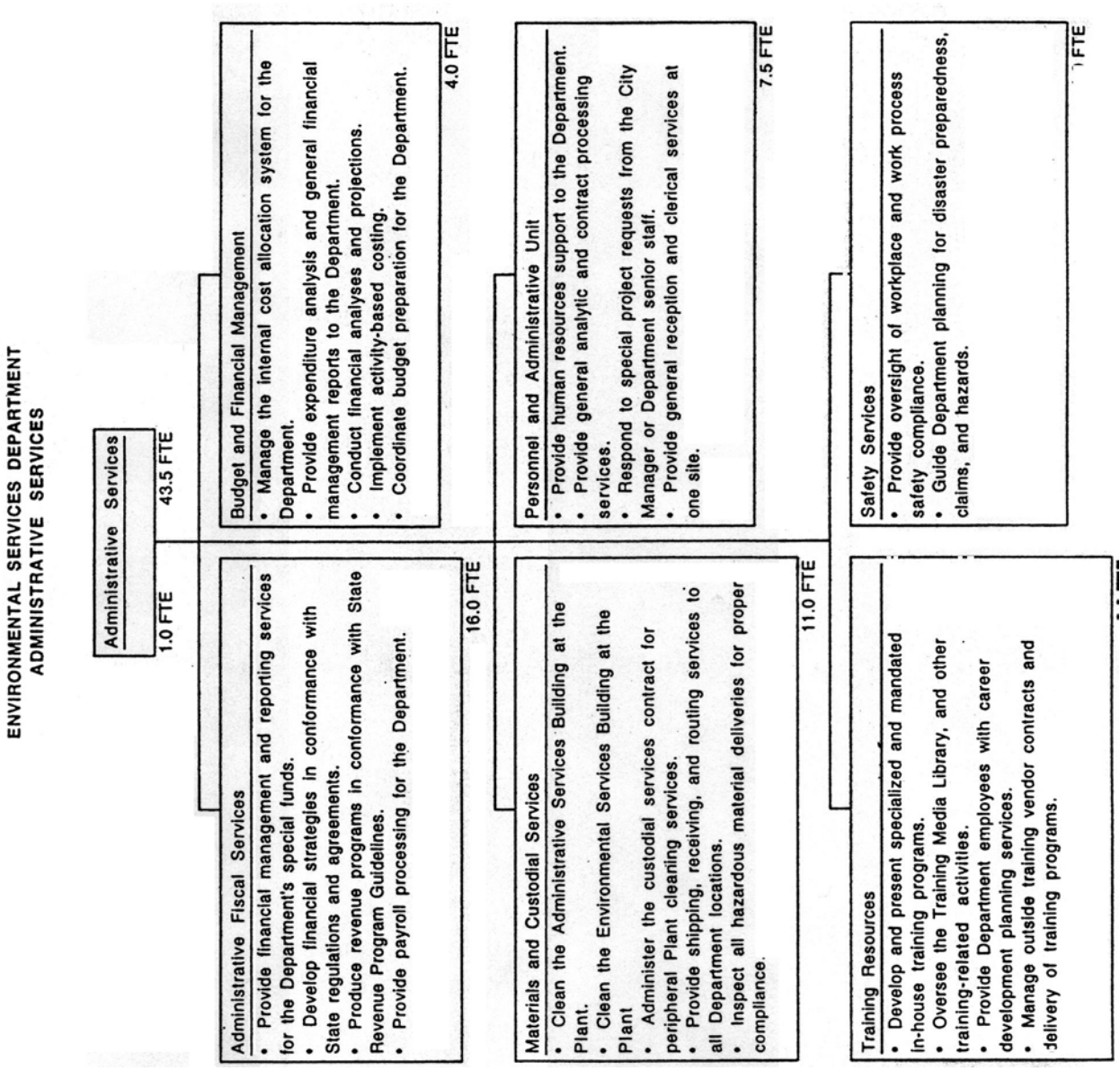
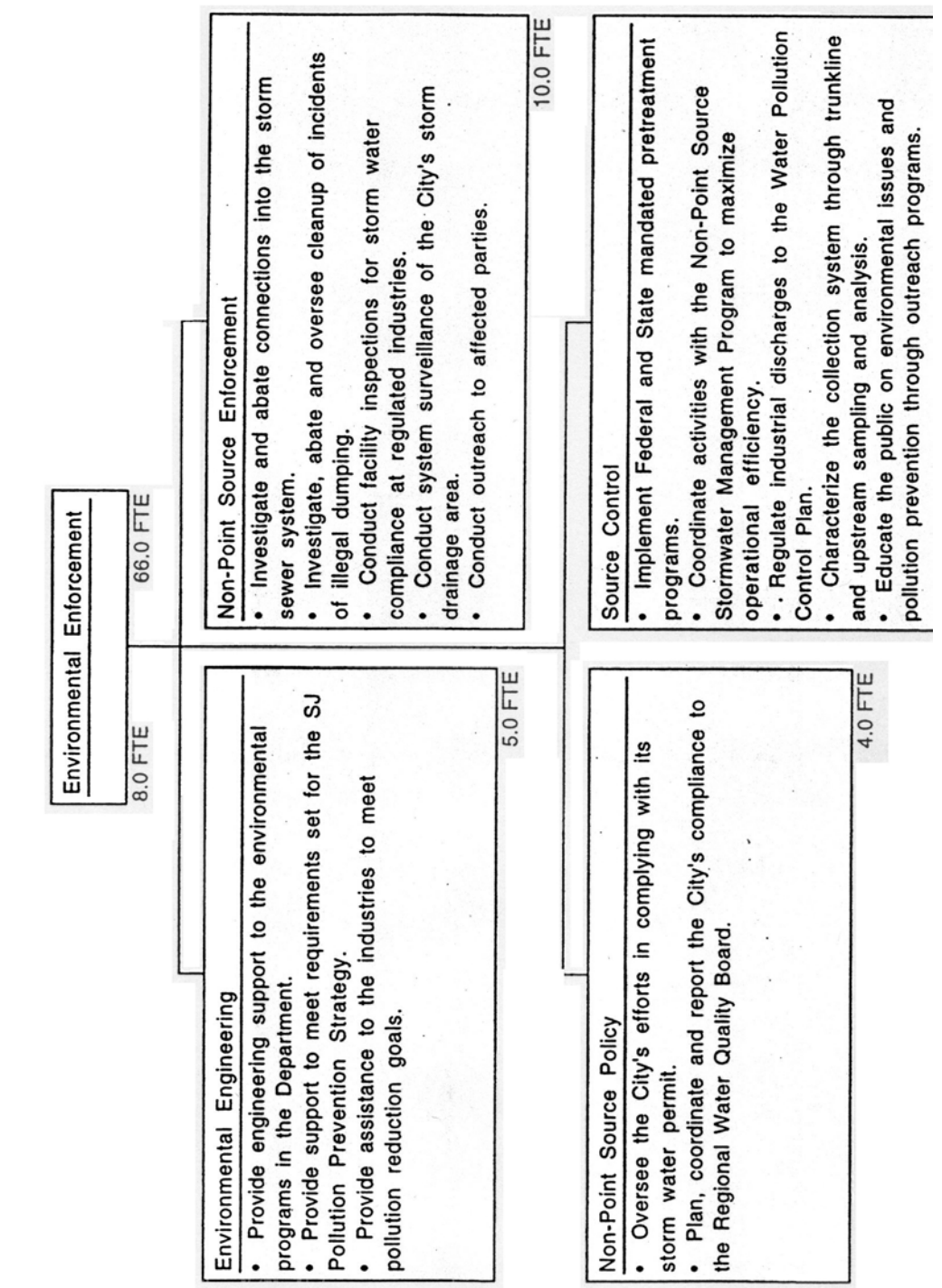


CHART II

ENVIRONMENTAL ENFORCEMENT ORGANIZATION CHART



Billing Services Unit Of Treasury

Chart III shows the organization of the Treasury Billing Services Unit. Billing Services is responsible for billing and collecting most residential and commercial SSUC and storm drain fees.

Billing Services maintains a database for placing these fees on the property tax rolls. In 1997-98, the database had information on 214,717 records. According to Department of Information Technology (IT) staff, the Sewer Billing database is the most accurate and complete database in the City. Billing Services staff periodically cross check their records to County reports, and annually cross check their records to the SITUS[1] database the IT maintains. Billing Services staff also receives information from the following City sources:

- The Planning Department's monthly Building Permit Report (includes sewer connections, sewer caps, and septic abatements);
- The City Clerk's Office reports on annexations; and
- Utility Billing Service listings of new customer accounts.

Billing Services also uses customized database reports to conduct field and desk verifications of various classifications of sewer users as time permits.

[1] The SITUS database is a citywide datafile of addresses, owner names, and assessor parcel numbers.

FINANCE DEPARTMENT
TREASURY

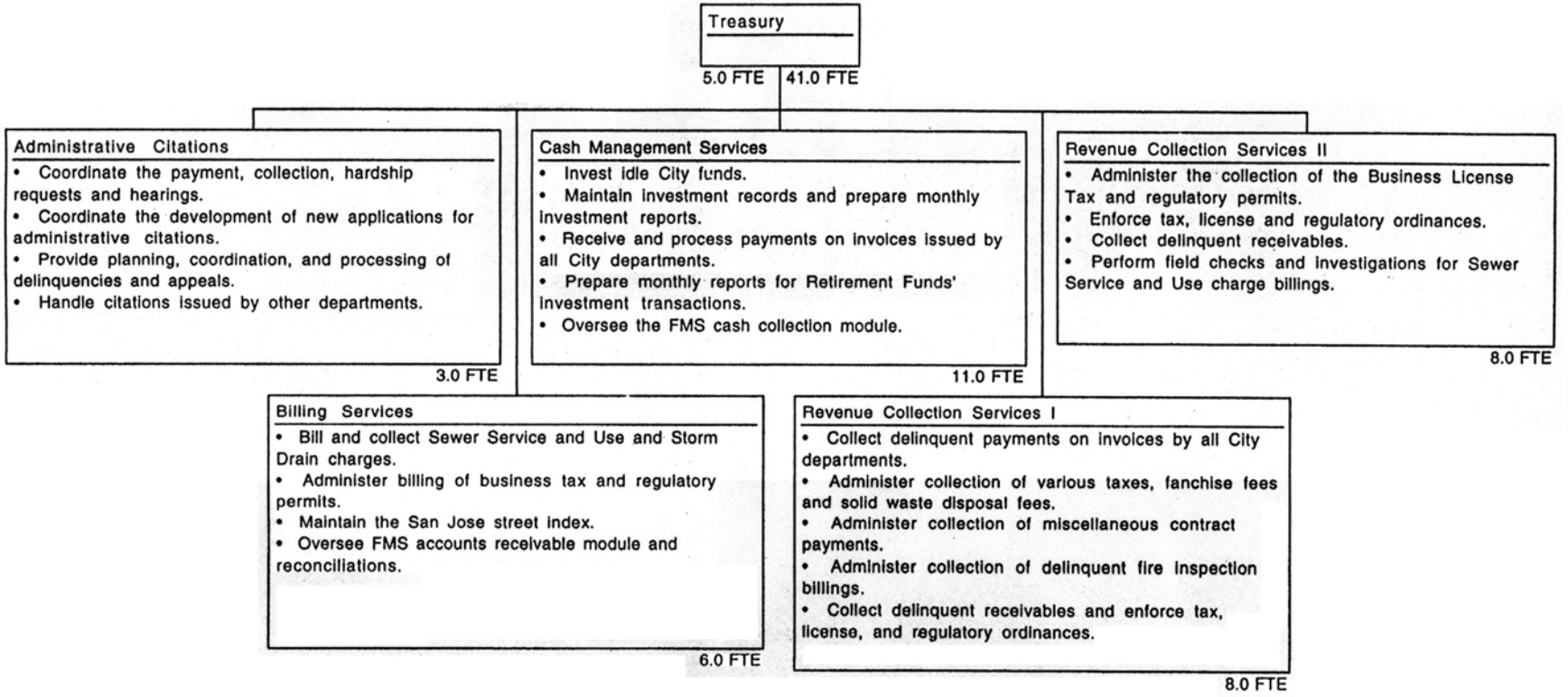


CHART III
TREASURY ORGANIZATION CHART

SCOPE AND METHODOLOGY

The objective of our review of sewer billing services was to evaluate the effectiveness of the internal controls over the accuracy and proper remittance of Sewer Service and Use Charge (SSUC) fees. We met with the Environmental Services Department (ESD) and the Treasury Division of the Finance Department (Treasury) to determine the scope of their responsibilities for billing for SSUC Fees. We observed staff operating both the ESD's and Treasury's sewer billing databases. We toured a monitored and an unmonitored facility with a Source Control Inspector.

We reviewed Treasury's controls over the accuracy of parcel locations and standard industry classifications in the sewer billing database. We verified that Treasury is following its written procedures that ensure data integrity.

We documented both the ESD's and Treasury's processes for obtaining monthly water flow information for billing purposes, and observed how adjustments to monthly water flow information are determined and applied. We calculated the revenue impact of those adjustments. We spot checked the accuracy of flow information in the databases to source documents. We surveyed other local jurisdictions about their policies and procedures for estimating sewer flow.

We met with staff from the ESD's Technical Support and Environmental Enforcement divisions to determine how sampling schedules are established, and to document that the ESD has a quality assurance program in place for handling laboratory samples. We tested the transfer of data from laboratory reports and other source documents into the ESD's billing database.

We performed limited testing to determine the accuracy and reliability of information in the computer databases that the ESD and Treasury use. We reviewed database password controls, backup and contingency plans, and tested the methodology used to calculate SSUC invoices.

We reviewed the ESD's and Treasury's controls over the billing and collection of invoiced amounts. We documented Treasury's procedures for placing sewer fees on the

County of Santa Clara's (County) assessment rolls, and reviewed documentation of final charges for 1996-97 and 1997-98.

We interviewed Treasury staff regarding their procedures for handling sewer invoices, payments, and delinquencies. We tested recent sewer accounts receivable activity to determine whether Treasury had assessed all applicable delinquent penalties, and collected long overdue accounts.

FINDING I

THE ENVIRONMENTAL SERVICES DEPARTMENT NEEDS TO IMPROVE ITS DOCUMENTATION AND SUPERVISORY APPROVAL OF $1.5 MILLION PER YEAR IN REDUCTIONS TO SEWER SERVICE AND USE CHARGES

The City of San Jose Municipal Code (Code) requires the Environmental Services Department (ESD) to compute Sewer Service and Use Charge (SSUC) Fees based upon the volume and strength of sewage discharged into the sanitary sewer system. In most cases, ESD uses metered water consumption to estimate sewage flow. We identified that the ESD has approved reductions to the estimated volume of flow for about 50 monitored industrial locations and about 500 unmonitored commercial locations. Consequently, the ESD reduced SSUC Fees by about $1.5 million per year. However, we also identified that the ESD made these $1.5 million in annual SSUC Fee reductions without:

- Written criteria for doing so;
- Written justifications for disparate reductions among similar companies;
- Written notification of the affected companies regarding the flow reductions used to calculate their SSUC Fees;
- Documented supervisory review and approval;
- Regular reviews of flow reduction factors; or
- Showing flow adjustments on customer invoices.

As a result, the ESD may be granting unwarranted SSUC Fee reductions or treating customers inequitably.

We also identified that, for purposes of calculating the capital cost recovery portion of SSUC Fees for monitored industries, the City of San Jose has a long-standing practice of granting an additional 50 percent reduction to the estimated volume of sewage that some seasonal industries discharge into the sanitary sewer system. We estimate that because of this additional 50 percent reduction, the ESD reduces the capital cost recovery

portion of the SSUC Fees by an additional $24,000 per year. As a result, the ESD may be granting SSUC Capital Cost Recovery Fee reductions that are not warranted.

In our opinion, the ESD should improve its documentation and supervisory approval of reductions to SSUC Fees. In addition, the ESD should require installation of water diversion meters and/or sewage flow meters at additional commercial locations in order to increase the accuracy of its sewer flow estimates. Furthermore, the ESD should establish policies and procedures to verify over 600,000 hundred cubic feet (HCF) or $840,000 of self-reported water and/or sewage flow billing information during 1997-98. Finally, the ESD should reconsider its longstanding practice of granting 50 percent flow reductions to canneries as part of its pending sewer rate structure review.

Code Requirements

The Code requires that SSUC Fees be computed based on the volume of sewage, amount of biochemical oxygen demand (BOD), amount of suspended solids (SS), and the amount of ammonia (NH3) discharged into the sanitary sewer system. The Code also requires that standard laboratory procedures, applicable state and federal regulations and guidelines, and records of past water consumption be used to estimate sewage flow and concentrations. The Code allows alternative methods for analyses of the sewage flow with the consent of the interested owner of the premises involved.

Annual Rate Resolution

The Code also requires an annual review of SSUC rates to assure their adequacy in recovering capital, operating and maintenance costs "in a manner which is proportional to the volume and strength of sewage discharged by each class of premises into the sanitary sewer system." In accordance with these provisions, the City Council annually adopts a rate resolution including three residential classifications (annual rate per unit), 21 commercial and light industrial classifications (charge per HCF of estimated annual flow), and one monitored industrial classification (charge per million gallons per day of flow, and pounds per day of BOD, SS, and NH3). These rates are shown in the Background section of this report.

ESD Adjustments To Estimated Volumes Discharged Into The Sanitary Sewer System

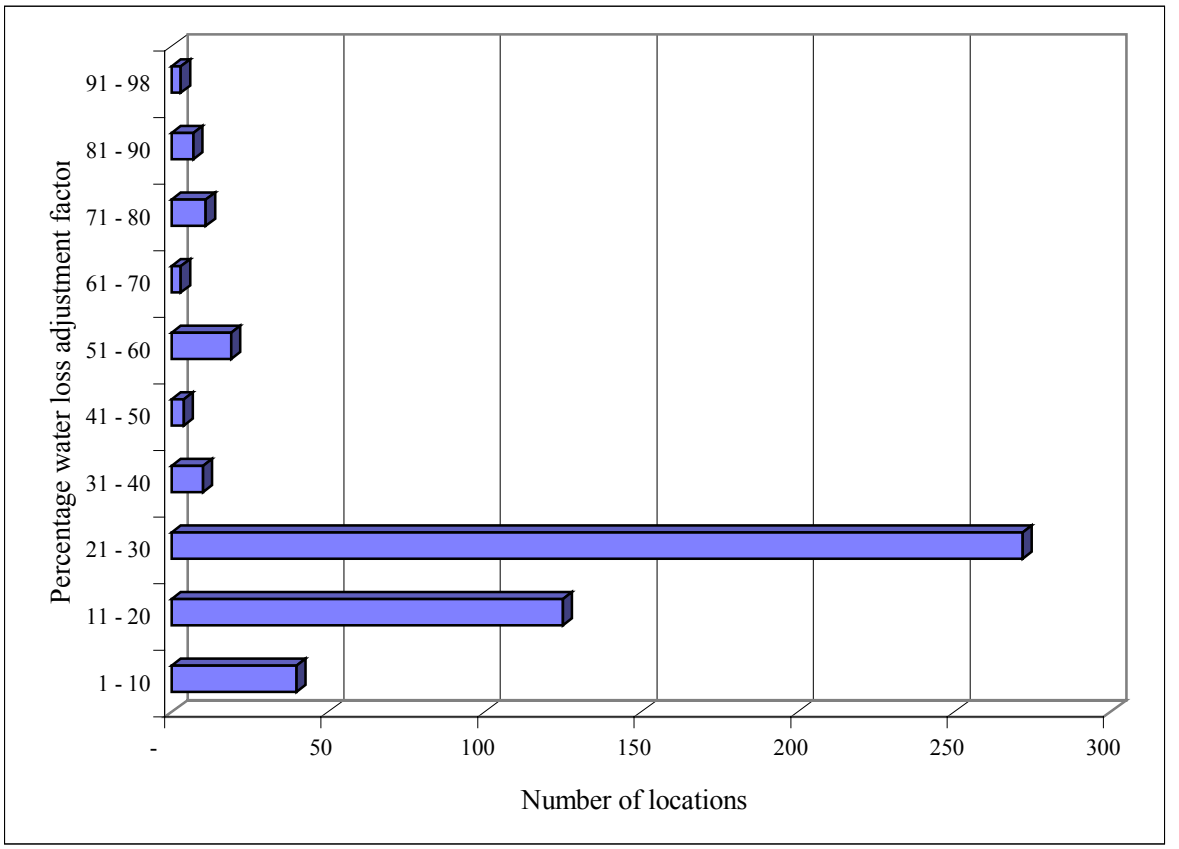
The ESD estimates sewage flow for most non-residential users based on water usage data it obtains from water companies. The Billing Services Unit (Billing Services) of the Treasury Division of the Finance Department (Treasury) collects water usage data from local water providers for approximately 9,400 non-residential locations. Billing Services averages the metered water consumption of these users for the months of January, February and March of the previous fiscal year, and extends the data for the following year. Billing Services uses these months to minimize the effect of landscape and garden irrigation on metered water usage. In addition, Billing Services does not bill for water meters exclusively serving landscaped areas.

The ESD also assigns individual percentage-based flow adjustment factors to account for additional water flow that is diverted from the sewer system. For example, the ESD has granted flow adjustment factors to individual commercial users to account for water loss due to extensive landscaping (5 percent to 30 percent), cooling towers (10 percent to 25 percent), laundries (usually 11 percent), cement plants (65 to 98 percent), ice plants (15 percent to 75 percent), schools (usually 27 percent), and several other types of uses.

Billing Services bills approximately 500 locations using these types of percentage flow adjustment factors. Graph II shows the distribution of the 500 flow adjustment factors among the unmonitored commercial and light industrial locations that Billing Services bills annually.

GRAPH II

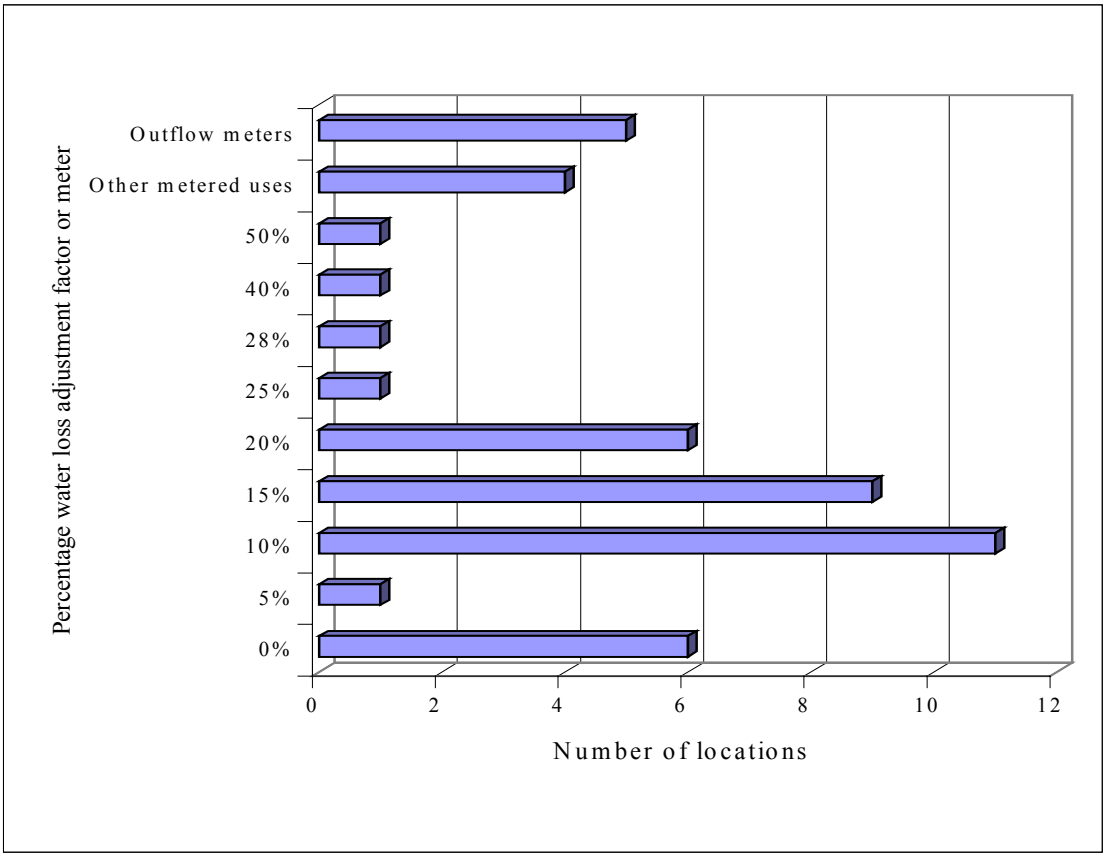
UNMONITORED COMMERCIAL AND LIGHT INDUSTRIAL LOCATIONS' FLOW ADJUSTMENT FACTORS (AS OF MAY 1998)



The Administrative Services Division of the ESD is responsible for collecting monthly water usage data for the 50 monitored locations. Some of these locations have sewage outflow meters or diversion meters. The ESD bills many of these locations using percentage-based flow adjustment factors. Graph III shows the distribution of flow adjustment factors among the monitored industrial locations that the ESD bills monthly.

GRAPH III

MONITORED INDUSTRIAL LOCATIONS' FLOW ADJUSTMENT FACTORS (AS OF OCTOBER 1997)



The ESD Reduces Fees About $1.5 Million Per Year

We estimate that these percentage-based flow adjustment factors reduce annual SSUC Fees by about $1.5 million per year. Specifically, the ESD authorizes at least $381,000 per year in percentage-based flow adjustments to about 50 monitored industrial locations and approximately $1,150,000 per year in adjustments to about 500 of the 9,400 unmonitored commercial locations.

In some cases, substantial fee reductions are involved. For example, during the first eight months of 1997-98, a local cannery used 156,000 HCF of water. The City estimates that only 80 percent of that flow was discharged through the sewers. Thus, the

company's water loss adjustment factor is 20 percent, or more than 31,000 HCF for that period. It should be noted that this is in addition to the 50 percent flow adjustment factor in the company's capital cost recovery charge calculation because it is a dry-weather peak user. We estimate that the 20 percent flow adjustment reduced the company's annual SSUC operating cost recovery fees by approximately $43,000, and the 50 percent flow adjustment reduced the company's SSUC Capital Cost Recovery Fee by an additional $24,000.

Survey Of Other Local Jurisdictions

Our review revealed that, like San Jose, the Cupertino Sanitary District and the City of Santa Clara also estimate flow on metered water usage less an allowance for water that is used on the premises and diverted from the sewer system. Specifically:

- The Cupertino Sanitary District bills commercial customers based on metered water use. District inspectors estimate percentage water loss factors for individual customers; these water loss factors range from 10 percent to 80 percent.

- The City of Santa Clara (Santa Clara) bills commercial users based on "sewage volume as a percentage of metered water use" for 16 standard industrial classifications (SIC) with a corresponding flow adjustment factor for each SIC. Santa Clara lists and approves these flow adjustment factors as part of the annual rate ordinance.

Our review also revealed that the City of Palo Alto, like San Jose, annualizes winter water usage.

However, it should be noted that several local jurisdictions avoid using percentage-based flow adjustment factors. For example:

- The City of Milpitas (Milpitas) bills commercial customers based on metered water use or metered discharge. Milpitas does not use percentage-based flow adjustment factors.

- The City of Sunnyvale (Sunnyvale) bills commercial sewer customers based on metered water use exclusive of landscape meters. In addition, Sunnyvale will reduce the flow component of a customer's bill based upon customer-submitted documentation of other diverted water uses and/or installed sewage discharge meters.

- West Valley Sanitary District (District) bills commercial customers based on metered water usage. The District requires that customers provide a licensed civil engineer water usage study before granting a water flow adjustment.

Because of the wide variation in methods for estimating flow, and because no one has done a recent comprehensive review of the ESD's system of granting flow adjustment factors, we recommend that the ESD include a reassessment of its flow adjustment factors in its pending sewer rate structure review.

Recommendation #1

The ESD include a reassessment of its percentage-based flow adjustment factors in its pending sewer rate structure review. (Priority 3)

The ESD Needs Written Criteria, Justifications And Agreements, Plus Documented Supervisory Review, Regular Reviews Of Fee Reductions And Invoice Adjustments

Our review also revealed that the ESD has not prepared written policies or procedures for determining flow adjustment factors. In addition, although ESD staff members were generally able to provide verbal explanations for why some users had different flow reduction factors than other users, the ESD does not have up-to-date, written documentation of the reasons for granting flow adjustment factors, or justifications for disparate reductions among similar companies. Furthermore, we found that one ESD staff member was responsible for conducting site reviews and approving loss adjustment factors. We found no evidence of documented supervisory review and approval for the loss adjustment factors the ESD staff member granted to various companies.

Regular Reviews Of Flow Reduction Factors

Our review also revealed that no one reviews flow reduction factors on a regular, scheduled basis to determine whether a particular factor is still appropriate. We found that these billing systems have been in place for years and are complaint-driven. Specifically, ESD staff reviews unmonitored user locations on a case-by-case basis, usually only when staff in Billing Services requests the review.

The ESD May Be Granting Unwarranted Fee Reductions Or Treating Customers Inequitably

Because the ESD does not regularly review flow adjustment factors, questionable flow adjustments may go undetected. For example, we found an unmonitored business in the parking lot at Valley Fair with minimal landscaping, that has a 29 percent loss factor in Treasury's sewer billing database. This is in addition to the adjustment for landscape irrigation which is implicit in the City's flow calculation for commercial and light industrial sewer users (see page 3 of this report). According to the notation in the database, the reason for the factor is "extensive landscape". As a result, we estimate the City has reduced this business's bill by about $450 per year.

Recommendation #2

The ESD document its methodology for estimating sewer flow and its criteria for granting water loss adjustments. In addition, the ESD should annually review existing water loss adjustment factors for both monitored industries and unmonitored companies and require supervisory review and approval of all changes to those factors. (Priority 2)

Written Notification Of The Affected Companies

We found that flow adjustment factors do not appear on customer invoices. Furthermore, the ESD does not provide affected companies with written notification regarding the flow reductions used to calculate their SSUC Fees. As a result, individual users may not know the basis for calculating their SSUC Fees. This makes it more difficult for customers to verify the appropriateness of loss adjustment factors.

The Code authorizes the Director of Water Pollution Control, "on the basis of standard methods, [and] standard engineering practices . . . [to] determine the adequacy and appropriateness of methods employed to measure the volume of sanitary sewage." In addition, at his or her discretion "and with the consent of the interested owner of the premises involved," the Director may use alternative measurement methods.

In our opinion, the ESD and Treasury could improve communication with users by showing the methodology used to estimate sewer flow on their bills. For example, an explanation of "metered water usage less 10 percent allowance for one cooling tower" would allow a user to confirm the basis for the flow calculation. It should be noted that the ESD already puts explanatory notes on the attachments to its invoices when it uses averages of prior months' sample results to calculate current month charges. It should also be noted that although the ESD prepares some bills monthly, Treasury usually prepares written invoices only for first year partial payments.

Recommendation #3

The ESD and Treasury print explanatory notes on SSUC invoices showing the methodology for estimating sewer flow and the water loss adjustment factor when applicable. (Priority 3)

Use Of Sewage Discharge And Water Diversion Meters

During the month we reviewed, the ESD billed the majority of its monitored industrial users using metered water inflow less a water loss adjustment factor. The ESD billed only five users on the basis of sewage discharge meters and only four users on the basis of metered inflow less metered diversion.

The Code authorizes the Director of Water Pollution Control to require owners of commercial, industrial or miscellaneous premises to install and maintain measurement and sampling devices for the purpose of computing SSUC Fees. Billing would be simpler if sewer discharge meters were installed at all major industrial locations.

Another common means of estimating water consumption on premises is the installation of additional water meters to measure water used exclusively for landscaping, or diverted to evaporative use in cooling towers. In our opinion, the ESD can improve the accuracy of its sewer flow estimates by requiring the owners of commercial, industrial and miscellaneous premises to install additional sewer and/or additional water diversion meters wherever possible.

Recommendation #4

The ESD implement policies and procedures requiring owners of commercial, industrial and miscellaneous premises to install sewer meters and/or additional water meters wherever possible. (Priority 3)

The ESD Does Not Regularly Verify Self-reported Flow Information

We estimate that during 1997-98 monitored companies self-reported more than 600,000 HCF of water and/or sewage flow. We estimate that monitored companies paid at least $840,000 in SSUC Fees based on this self-reported flow information. According to ESD staff, they read some meters, but generally do not verify self-reported flow information. In our opinion, the ESD should periodically verify self-reported flow information.

Recommendation #5

The ESD implement policies and procedures to periodically verify self-reported flow information. (Priority 2)

SSUC Capital Cost Recovery Fee Reductions May Not Be Warranted

Monthly SSUC Fees for monitored industrial users are calculated in two parts – a SSUC operations and maintenance cost recovery fee, and a SSUC Capital Cost Recovery Fee. Our review revealed that the City has a long-standing practice of layering an additional 50 percent flow reduction factor on the flow used to calculate SSUC Capital

Cost Recovery Fees for certain seasonal industries whose peak flow is during dry weather months.

In theory, certain seasonal industries with peak flows during July, August, and September use the WPCP's capacity needed to handle the infiltration/inflow of rainfall and groundwater leakage into the sanitary sewer system during the winter months. However, in actual practice, only one user (a cannery) falls into this category. We estimate that the ESD reduced this cannery's SSUC Capital Cost Recovery Fees by $24,000 per year. In our opinion this $24,000 fee reduction may no longer be warranted. We recommend that the ESD reconsider this practice as part of its pending sewer rate structure review.

Recommendation #6

The ESD review its policy of reducing SSUC Capital Cost Recovery Fees by half for users with peak use during dry weather months. (Priority 3)

CONCLUSION

Our review revealed that the ESD uses percentage flow reduction factors to bill about 50 monitored industrial locations and about 500 unmonitored commercial locations. We estimate these percentage reductions reduce SSUC Fees by about $1.5 million per year. We identified that the ESD made these $1.5 million in annual SSUC Fee reductions without written criteria, justifications, notification, or documented supervisory review and approval. In addition, the ESD has not regularly reviewed flow reduction factors, or shown flow adjustments on customer invoices. In our opinion, the ESD can improve the accuracy of its sewer flow estimates by requiring owners of commercial, industrial, and miscellaneous premises to install additional water diversion meters and sewage flow meters when practical to do so. In addition, the ESD should establish policies and procedures to verify customer self-reported water flow information. Finally, the ESD should review its policy of reducing SSUC Capital Cost Recovery Fees by half for monitored industries with peak dry season flows.

RECOMMENDATIONS

We recommend that the Environmental Services Department:

Recommendation #1

Include a reassessment of its percentage-based flow adjustment factors in its pending sewer rate structure review. (Priority 3)

Recommendation #2

Document its methodology for estimating sewer flow and its criteria for granting water loss adjustments. In addition, the ESD should annually review existing water loss adjustment factors for both monitored industries and unmonitored companies and require supervisory review and approval of all changes to those factors. (Priority 2)

We also recommend that the Environmental Services Department and Treasury:

Recommendation #3

Print explanatory notes on SSUC invoices showing the methodology for estimating sewer flow and the water loss adjustment factor when applicable. (Priority 3)

We further recommend that the Environmental Services Department:

Recommendation #4

Implement policies and procedures requiring owners of commercial, industrial, and miscellaneous premises to install sewer meters and/or additional water meters wherever possible. (Priority 3)

Recommendation #5

Implement policies and procedures to periodically verify self-reported flow information. (Priority 2)

Recommendation #6

Review its policy of reducing SSUC Capital Cost Recovery Fees by half for users with peak use during dry weather months. (Priority 3)

FINDING II

THE ENVIRONMENTAL SERVICES DEPARTMENT EXCEEDED ITS MUNICIPAL CODE AUTHORITY WHEN IT REDUCED TWO SEWER SERVICE AND USE CHARGE INVOICES BY A TOTAL OF $323,000

The City of San Jose Municipal Code (Code) specifies that the Director of Finance has the authority to correct a disputed Sewer Service and Use Charge (SSUC) Fee. Similarly, the Code authorizes the City Council to adjust SSUC Fees to any particular premises if the charges are unfair or inequitable. However, during our audit we identified two instances where the Environmental Services Department's (ESD) Administrative Services Division adjusted one SSUC Fee by $306,000 and another SSUC Fee by $17,000. The Director of Finance and the City Council were not involved or advised of these SSUC Fee adjustments. Further, we could not find any evidence of ESD supervisory review or approval of these SSUC Fee adjustments. In our opinion, the ESD needs to ensure that its staff is aware of the SSUC Fee adjustment Code requirements and develop written procedures to ensure compliance with Code requirements. By so doing, the ESD will help assure compliance with the Code and reduce the risk that its staff could inappropriately adjust customers' bills.

Code Requirements

The Code outlines the process for handling SSUC billing errors and adjustments in SSUC charges.

Billing Errors

The Code specifies that an owner disputing the amount of a SSUC invoice should file a claim with the Director of Finance accompanied by supporting factual data. If the Director of Finance, after consulting with the City Engineer, determines that the bill was in error, the Director of Finance is authorized to correct the bill. In our opinion, this Code section outlines a method for correcting billing errors such as transcription errors, calculation errors, and incorrect rates applied.

Adjustments In Charges

The intent of the Code in establishing different SSUC charges for different classes of premises is "to establish higher charges for those classes of premises which derive greater benefit from, or impose greater burdens upon, the sanitary sewer system because of the quantity, quality or rate of flow of sanitary sewage" discharged. The Code also establishes a means to make adjustments in charges if the City Council deems a rate to be unfair. Specifically, if the City Council finds that the charge related to any particular premises is unfair or inequitable, the City Council may "by resolution, agreement or otherwise, establish a special sewer service and use charge for such premises, different from those above provided, and having a closer relationship to the benefit received, or burden placed, by such premises from or upon said sanitary sewer system."

ESD Adjustments

Our review revealed that the ESD has not established adequate procedures for approving billing Code-defined corrections or adjustments.

The ESD Adjusted One Fee By $306,000 By Adjusting The Methodology It Used To Calculate Peak Flow And Loadings

Monitored companies pay SSUC Capital Cost Recovery Fees based on peak flows and loadings (highest month in the year). There are no written criteria for waivers from this policy. However our review of SSUC invoices revealed a case where a company requested, and ESD staff granted, an adjustment to the company's annual bill based on the fact that the company's peak monthly flow (during August) was unusually high. The ESD and the company agreed to average biochemical oxygen demand (BOD) for July and August, and suspended solids (SS) loadings for August and September. By so doing, the ESD reduced the company's annual SSUC Capital Cost Recovery Fee by $306,000.

In our opinion, this was not a correction of a billing error. Instead, it was a billing adjustment with a substantial dollar impact. As such, it should have been forwarded through the Director of the ESD and the Director of Finance to the City Council for approval.

The ESD Adjusted Another Fee By $17,000 By Excluding Certain Sample Results

The sewer rate structure specifies that monitored industrial users "are billed monthly on the basis of samples collected during the billing period." The sewer rate structure does not make exceptions for unusual flows or unusual sample results. Further, the ESD does not have written criteria for excluding sample results.

We identified a case where a company requested and ESD staff agreed to exclude several sample results based on unusual flows. Specifically, the company requested that the ESD exclude three sample results that the company considered unusually high. According to the company, one of the results was due to a special clean-up, and two results may have been due to a boiler malfunction that required some clean-up or perhaps to inaccurate testing. ESD staff agreed to exclude all three days' sample results, plus two additional results. In total the Administrative Services Division excluded 5 out of 16 sample results for the month, and issued a new invoice for $17,000 less than the original invoice.

In our opinion, unusual flows do not necessarily warrant an adjustment in charges, particularly in cases where bills are computed from an average of many samples. Basing SSUC Fees on an average is designed to mitigate against, but not exclude, both higher-than-average and lower-than-average daily flows.

Furthermore, the ESD's laboratory goes to considerable lengths to ensure the quality of its test results. Accordingly, the ESD should document its criteria and approval process for disregarding a SSUC sample result and excluding it for SSUC billing purposes.

Moreover, the ESD files we reviewed did not include written justifications or evidence of supervisory review or approval for the excluded sample results. In fact, we found that in general the ESD's files did not adequately document (1) the reasons for deviating from standard ESD practices, (2) reasons for making billing adjustments, or (3) supervisory review or approval of either. As a result, the ESD is exposed to the risk that it does not bill its users fairly, and/or its employees could inappropriately manipulate customer bills.

The Director Of Finance And The City Council Were Not Involved Or Advised Of Fee Adjustments

Supervisory review or approval was not documented for either of the above-cited billing adjustments. At the very least, a highly placed ESD official should have reviewed and approved billing corrections of this magnitude. As noted above, the Code only authorizes the Director of Finance to approve corrections to erroneous bills and the City Council to approve billing adjustments when charges are unfair or inequitable.

In our opinion, the ESD needs to ensure that its staff is aware of the SSUC Fee adjustment code requirements. In addition, the ESD should prepare written policies and procedures for handling disputed SSUC bills, obtaining supervisory review and approval, and forwarding disputes to the Director of Finance and the City Council when necessary.

Recommendation #7

The ESD ensure that its staff is aware of the SSUC Fee adjustment code requirements. (Priority 2)

Recommendation #8

The ESD establish criteria, procedures, and a supervisory review and approval process for correcting disputed SSUC bills and approving billing adjustments in accordance with the Municipal Code. (Priority 2)

CONCLUSION

The ESD does not have written policies and procedures for correcting SSUC billing errors or documenting supervisory review and approval of such corrections. Our review of SSUC invoices revealed that the ESD exceeded its authority when it approved SSUC billing adjustments totaling $323,000.

RECOMMENDATIONS

We recommend that the Environmental Services Department:

Recommendation #7

Ensure that its staff is aware of the SSUC Fee adjustment code requirements. (Priority 2)

Recommendation #8

Establish criteria, procedures, and a supervisory review and approval process for correcting disputed SSUC bills and approving billing adjustments in accordance with the Municipal Code. (Priority 2)

FINDING III

THE ENVIRONMENTAL SERVICES DEPARTMENT NEEDS TO IMPROVE ITS BILLING PROCEDURES FOR MONITORED INDUSTRIAL SEWER USERS

In accordance with its sewer rate schedule, the Environmental Services Department (ESD) should bill monitored industrial sewer users monthly on the basis of samples collected during the billing period. Sewer Service and Use Charge (SSUC) Fees for monitored industrial sewer users should be based on estimated or metered flow for the month adjusted for levels of biochemical oxygen demand (BOD), suspended solids (SS) and ammonia (NH3). Our audit of the ESD's billing procedures for monitored industrial sewer users revealed that the ESD

- Used disparate time periods to calculate flows and levels of BOD, SS, and NH3;
- Used disparate sampling schedules;
- Did not test all monitored companies;
- Arbitrarily excluded individual sampling results;
- Did not provide affected companies with written notification of flow reduction or sampling schedules;
- Erroneously omitted zero sampling results; and
- Made flow information transcription errors.

While the net effect of the above errors and inconsistencies was less than $10,000, larger and more costly future mistakes could occur and go undetected and uncorrected. Accordingly, the ESD should document the reasons for any deviations from its standard billing practices, implement procedures to identify and correct inadvertent billing errors and omissions, and establish written procedures for handling sampling results. By

implementing these procedures the ESD will have added assurance that it is billing its monitored industrial sewer users fairly and appropriately.

Sewer Rate Schedule

In 1988, the City Council removed the fee-setting provision from the San Jose Municipal Code (Code) and authorized the City Council to set such charges by resolution. Accordingly, the City Council adopts an annual resolution setting the schedule of SSUC Fees.

Monitored Industrial SSUC Rates

The annual resolution sets monthly SSUC Fees for various types of users including non-residential users discharging more than 25,000 gallons of sewage per day or discharging sewage of widely varying strength. The resolution sets SSUC rates for these major industrial users based on each:

- Million gallons per day and million gallons per year of sewage discharged (flow), and
- Thousand pounds per day and thousand pounds per year of BOD, SS, and NH3 contained in the sewage discharged (strength or loadings).

The Code authorizes the Director of Water Pollution Control to use standard methods and standard engineering practices to measure the characteristic sewage flow and strength that users are discharging into the sanitary sewer system for the purpose of computing SSUC Fees. The Code also allows the Director of Water Pollution Control or his or her authorized representatives, with the consent of the interest owner of the premises involved, to use alternative methods to analyze sanitary sewage so long as those methods "reflect the nature and quality of the sanitary sewage . . . being discharged into the sanitary sewer system."

ESD staff prepares an annual SSUC rate schedule implementing the City Council resolution. According to the ESD's sewer rate schedule, monitored industrial customers "are billed monthly on the basis of samples collected during the billing period."

Estimated annual SSUC Capital Cost Recovery Fees are computed and divided into 12 equal monthly increments for billing purposes.

Calculated Industrial Sewer User Fees For Monitored Companies

Staff in the ESD's Environmental Enforcement Division are assigned to take periodic samples from the monitored industrial sewer users and deliver them to the ESD's Technical Support Division's laboratory. Each week, the laboratory performs about fifty BOD analyses, fifty SS analyses, and twenty-five NH3 analyses for monitored industries. The laboratory follows standard quality control procedures. The Administrative Services Division computes SSUC Fees using the results of these samples. Each of the customer invoices shows the calculations described below.

Operations And Maintenance Cost Recovery Component

The ESD computes the operations and maintenance cost recovery component of industrial SSUC Fees based on recorded or estimated flow during the month in hundred cubic feet (HCF), and estimated loadings of BOD, SS, and NH3 during the month in pounds. The ESD calculates estimated monthly loadings from sample results as follows:

Monthly flow (in HCF)
X Average sample result during the sampling period (in parts per million)
X 0.006243 (a conversion factor)
= Estimated loadings for the period (in pounds)

Capital Cost Recovery Component

The ESD calculates the capital cost recovery component of industrial SSUC Fees based on peak daily flows and loadings as follows:

Peak monthly flow (in million gallons)
÷ Number of working days in that month
= Estimated peak daily flow (million gallons per day)

The ESD calculates separately peak daily loadings of BOD, SS, and NH3 from the estimated loadings calculated above as follows:

Peak monthly average loadings per month (in thousand pounds)
÷ Number of working days in that month
= Estimated peak daily loadings (in thousand pounds per day)

As stated above, the ESD computes estimated annual SSUC Capital Cost Recovery Fees using the highest peak for the fiscal year-to-date, and divides that amount into 12 equal monthly increments for billing purposes.

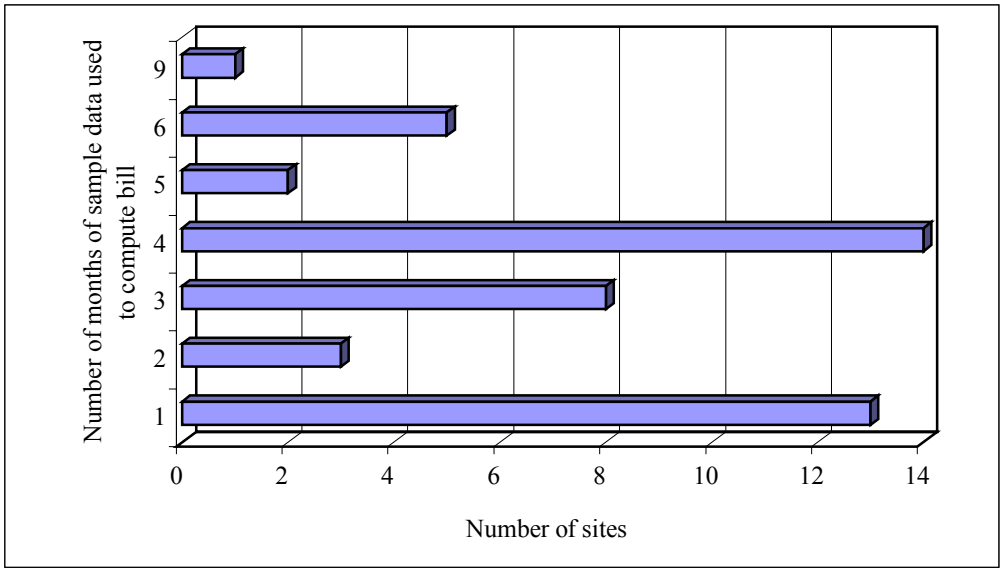
Billing Inconsistencies And Transcription Errors

Disparate Time Periods

As cited above, the ESD's SSUC rate schedule states that monitored industrial SSUC users are billed monthly based on samples collected during the billing period. However, we found that the ESD bills some monitored industrial users based on loadings for the current month, but bills other companies based on an average of prior months' loadings. The ESD billed one company based on a nine-month average. Graph IV shows the number of months of samples that the ESD used to compute sewer bills in October 1997.

GRAPH IV

NUMBER OF MONTHS OF DATA USED TO COMPUTE SEWER BILLS FOR MONITORED SITES IN OCTOBER 1997



The monthly averaging method the ESD uses can have a material impact on a user's SSUC bill for any given month. For example, in October 1997, the ESD billed one monitored company $9,298 based on a four-month average of sample results. However, we estimate that the ESD would have billed the same company an additional $1,697 if the ESD had used actual readings for the month. In another case, the ESD billed a company $12,748 based on a four-month average of sample results. In this instance, we estimate the ESD would have billed the company $512 less if the ESD had used actual readings for the month.

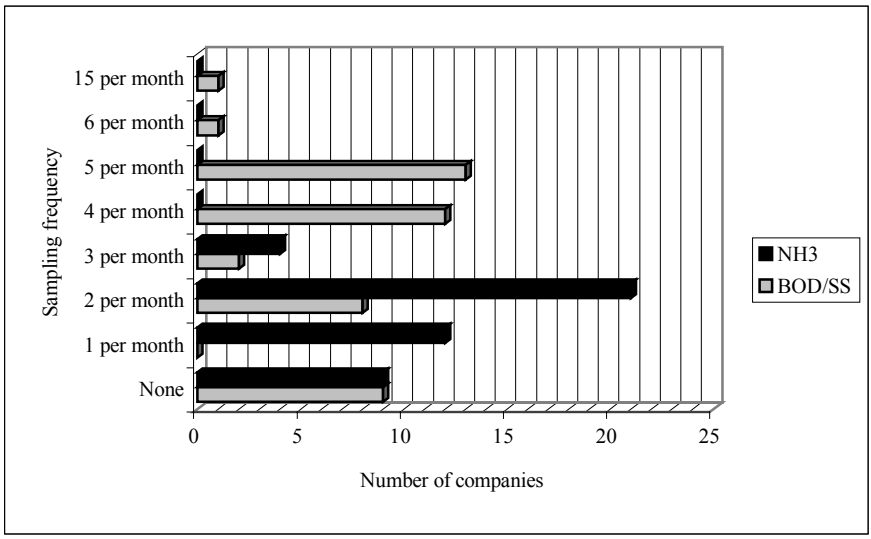
Our evaluation indicates that these inconsistencies tend to net out over the course of a year for operating cost recovery charges. However, it should be noted that the ESD calculates SSUC Capital Cost Recovery Fees based on the highest monthly reading during the entire fiscal year. Because the ESD has averaged samples across several months, the monthly loadings that the ESD retains in its billing database as peak loadings are actually averages of several prior months. This can cause the ESD to underbill customers for the SSUC Capital Cost Recovery Fee.

According to ESD billing staff, this situation developed because they felt that they needed sufficient data points for billing purposes. In our opinion, the ESD's Administrative Services Division and the Environmental Enforcement Division should meet annually to agree on sampling schedules that ensure adequate testing for monitored industrial users, thereby eliminating the need to base billings on averaged prior months' data.

Disparate Sampling Schedules

The ESD uses dramatically variable sampling schedules for the monitored industrial users. For example, Graph V shows the ESD's sampling frequency for the 46 monitored locations that the ESD tested in October 1997.

GRAPH V
SAMPLING FREQUENCY FOR MONITORED INDUSTRIAL LOCATIONS IN OCTOBER 1997



During the sample month that we reviewed, the ESD's laboratory processed 207 samples for monitored locations. The ESD's laboratory tested most of these samples for BOD and SS but tested less than half of the samples for NH3. Thus, when we reviewed SSUC invoices for these industrial users, NH3 readings were frequently blank. While blank readings do not affect billing calculations, our interviews with the ESD

Administrative Services Division staff indicated there was some confusion about blank lab results. Specifically, staff was unclear as to whether a blank reading was a zero reading or an omitted test. As a result, the ESD's Administrative Services Division was, in some cases, using prior months' NH3 readings in order to have enough data points to compute bills for some industrial users.

In our opinion, the ESD can clarify this situation by documenting why it treats some customers differently than others. Furthermore, the ESD should document its policies and procedures for determining sampling schedules for individual monitored industries. Finally, ESD staff in the Administrative Services Division and the Environmental Enforcement Division should meet at least annually to review sampling schedules to ensure adequate testing for billing purposes.

No Test Conducted

During the month we reviewed, we found that the ESD conducted no tests at nine of 46 locations that it billed. The ESD billed eight of these companies using their standard industry code and the same rates that the companies' unmonitored competitors pay.

We found one instance where the ESD added a brewery to its monitoring program in July 1997 but had not instituted a regular testing program for the brewery as of June 1998. As a result, the ESD was billing the brewery using the base rate for flow ($1.3786 per HCF) without additional charges for concentrations of BOD, SS, or NH3. This meant that the ESD billed the brewery $1,045 for the month of October. If the ESD had billed the brewery as an unmonitored soft drink bottler, its bill would have been $1,910. If the ESD had billed the brewery as an unmonitored winery, its bill would have been $3,343.

SSUC billing rates for monitored industries are meant to be comparable to their unmonitored competitors. For example, Treasury's Billing Services Unit (Billing Services) bills unmonitored electronics companies at the standard industry code rate of $1.72 per HCF. This is comparable to the $1.51 to $2.77 per HCF that the 17 monitored electronics companies in the testing program paid based on flow and sample results.

In order to charge monitored industries fairly, the ESD should either compute SSUC bills using all four components of the fee (flow, BOD, SS, and NH3), or bill the user at the standard industry rate for their type of business. Moreover, the ESD should clearly document in its files the reasons for any billings at unmonitored rates rather than monitored rates, and any evidence of supervisory review and approval.

Sampling Results Excluded

The SSUC rate structure specifies that monitored industrial users "are billed monthly on the basis of samples collected during the billing period." The SSUC rate structure does not make adjustments for unusual flows or unusual sample results. In practice, the ESD tests users with wide variation in the strength of their flows more frequently during the month, and bills these users on the average result. By so doing, the ESD mitigates against fluctuations in daily flows.

During the month we reviewed, ESD staff excluded for billing purposes nine sets of sample results that the ESD's laboratory forwarded to the Administrative Services Division. Our review revealed that the ESD does not have written criteria for excluding sample results. In addition, ESD files did not include written justifications or evidence of supervisory review or approval for these exclusions. Furthermore, in several cases ESD staff excluded these sample results because of unusual flows rather than invalid testing. For example, one company complained to the ESD about the inclusion of test results for three days that they considered to be unusually high. The ESD reacted to the complaint by excluding those three days from the SSUC Fee calculation. We discuss this case further in Finding II.

The Technical Support Division's laboratory goes to considerable lengths to follow standard quality control procedures. In our opinion, the ESD should carefully document its criteria and a supervisory review and approval process before excluding invalid and/or unusual test results when they occur.

Recommendation #9

The ESD establish criteria, procedures, and a supervisory review and approval process for (1) determining the frequency of testing at monitored industrial sites, (2) requesting additional samples, (3) using sample results from prior months for billing purposes, and (4) excluding sample results for billing purposes. (Priority 2)

Written Notification Of The Affected Companies

As cited in Finding I, the Code authorizes the Director of Water Pollution Control, "on the basis of standard methods, [and] standard engineering practices . . . [to] determine the adequacy and appropriateness of methods employed to measure the volume of sanitary sewage." In addition, at his or her discretion "and with the consent of the interested owner of the premises involved," the Director may use alternative measurement methods.

Our review revealed that although the ESD is in close touch with monitored users, the ESD does not provide affected companies with written notification regarding either the flow reductions (as cited in Finding I) or the sampling schedules that are used to calculate the company's SSUC Fees. As a result, individual users may not know how the ESD calculated their SSUC Fees.

Recommendation #10

The ESD annually review and notify monitored companies of next year's billing parameters including sampling frequency and analysis, flow estimation, and procedures to follow to resolve billing disagreements. (Priority 2)

Omitted Zero Sampling Results

During the sample month we reviewed, the ESD's sewer billing database did not properly record the results of 38 tests that had a "zero" result. According to ESD staff, the database omission of "zero" results was a computer program error. However, ESD

staff did not notice that zero results were missing because test sample results are frequently missing. Because the ESD excludes blank results when averaging loading calculations, the omission of true zero results skews the average loadings for the period. We estimate the effect of omitting zeros was only $428 on total billings of $466,000 for the month of October 1997. Although $428 is not significant, the ESD should correct its billing computer program to ensure that customers are properly billed and to avoid future potentially more costly errors.

Transcription Errors

Our review of October 1997 invoices also revealed several invoice transcription errors. Specifically, six out of 46 invoices we reviewed contained errors in flow information that resulted in about $15,000 in countervailing billing errors. We identified one invoice that was mistakenly based on the November flow reading instead of the October flow reading. This error resulted in a $10,000 underbilling to the customer. Another invoice we reviewed showed a flow reduction factor of 20 percent instead of the correct percentage of 28 percent. This error resulted in a $4,000 overbilling to the customer. The net effect of the errors we identified was only about $6,000 for the month we reviewed. However, these types of errors could potentially be material in a different month. Accordingly, the ESD needs to implement a supervisory review process to catch these types of errors before it calculates customer bills.

Recommendation #11

The ESD update its review and approval procedures to include proofreading data that is used to compute SSUC Fees including sample results and flow information. (Priority 3)

CONCLUSION

Our review revealed that the ESD needs to improve its billing procedures for monitored industrial sewer users. In our opinion, the ESD's files do not adequately document the reasons for deviations from standard ESD practices, for making billing adjustments, or supervisory review or approval of either. As a result, the ESD is exposed

to the risks of billing its users unfairly and its employees unfairly manipulating customer bills.

RECOMMENDATIONS

We recommend that the Environmental Services Department:

Recommendation #9

Establish criteria, procedures, and a supervisory review and approval process for (1) determining the frequency of testing at monitored industrial sites, (2) requesting additional samples, (3) using sample results from prior months for billing purposes, and (4) excluding sample results for billing purposes. (Priority 2)

Recommendation #10

Annually review and notify monitored companies of next year's billing parameters including sampling frequency and analysis, flow estimation, and procedures to follow to resolve billing disagreements. (Priority 2)

Recommendation #11

Update its review and approval procedures to include proofreading data that is used to compute SSUC Fees including sample results and flow information. (Priority 3)

FINDING IV

THE TREASURY DIVISION OF THE FINANCE DEPARTMENT NEEDS TO DEVELOP PROCEDURES TO ENSURE THAT PENALTIES ARE ASSESSED ON ALL DELINQUENT SEWER BILLS AND PAST DUE SEWER BILLS ARE COLLECTED

The Administrative Services Division (Administrative Services) of the Environmental Services Department (ESD) prepares monthly sewer and storm drain bills (Sewer Bills) for about 50 monitored industrial sewer users. The Treasury Division of the Finance Department (Treasury) is responsible for assessing City of San Jose Municipal Code (Code) prescribed 10 percent penalties on bills that are delinquent 40 days after the invoice date. However, because of Treasury's reliance on a manual bill tracking system, we identified at least 30 penalties totaling nearly $22,000 that Treasury did not assess. According to Treasury officials, Treasury collects past due bills by filing suit in Small Claims Court for amounts less than $5,000 or refers amounts over $5,000 to the City Attorney's Office for legal action. In addition, the Code prescribes who is authorized to approve the writing-off of bills less than and greater than $5,000. However, we identified nearly $63,000 in bills that were at least six months past due. We also identified that the City's Finance Administrative Manual (FAM) is out-of-date with regard to both the dollar limit for Small Claims Court and the dollar limits for approving writing-off uncollectable invoices. In our opinion, Treasury needs to develop written procedures regarding the assessment of penalties on bills and the collection of past due bills to ensure compliance with the Code and the FAM.

Administrative Services Division Of The ESD

Administrative Services prepares monthly Sewer Bills for approximately 50 monitored industrial sewer users. In accordance with the FAM, Administrative Services records customer and invoice information into the Accounts Receivable system, generating a two-part invoice form (the Accounts Receivable system assigns the invoice number). The Information Technology Department prints the invoices and forwards them back to the ESD for distribution. The ESD mails the original invoice (with backup

documentation) to the customer, and forwards the pink copy of each invoice to Treasury's Revenue Collection Unit.

Treasury Is Responsible For Assessing Penalties And Collecting Past Due Bills

The City's administrative policy is to centralize the collection and maintenance of accounts receivable records in Treasury. In keeping with this policy, Treasury is responsible for collection of Sewer Bills. The Code specifies that Sewer Bills are delinquent 40 days after the invoice date at which time Treasury is to add a 10 percent penalty to the Sewer Bill. Treasury is also responsible for collecting penalties on delinquent Sewer Bills.

Treasury's Manual Tracking System

Treasury's Accounts Receivable system automatically assigns invoice dates when staff enter an invoice into the Accounts Receivable system. The Accounts Receivable computer program's default (and only possible) due date is 30 days from the invoice date. However, Sewer Bills are not delinquent until 40 days from the invoice date. Therefore, Treasury relies on a manual system to flag delinquent sewer invoices. According to Treasury staff, the entire Accounts Receivable system would have to be reprogrammed to allow a 40-day due date.

A Treasury clerk receives the pink copies of the Sewer Bill invoices from the ESD. The clerk sorts and files the invoices by invoice date. As payments arrive, the clerk pulls the invoice copy, date stamps it paid, and batches payments for data entry into the FMS. In case of a partial payment, the clerk fills out a form and keeps the invoice until the balance is paid in full. Each day the clerk manually goes through the file of invoices and checks to see which invoices are overdue. If an invoice is overdue, the clerk forwards the invoice to a supervisor, who adds the 10 percent penalty into the Accounts Receivable system, and returns the pink invoice copy to the clerk. However, no one sends a copy of the invoice with the 10 percent penalty to the customer. If the customer subsequently pays the invoice in full, but does not pay the 10 percent penalty that Treasury added to the invoice, the clerk treats that payment as only a partial payment.

Once Treasury adds the 10 percent penalty to an invoice, the clerk forwards a copy of the invoice to the appropriate Investigator Collector in Treasury. Investigator Collectors mail collection letters and/or copies of delinquent invoices to delinquent customers on a cycle schedule of two contacts per month. The Investigator Collectors manually note delinquent penalties either on the collection letter or on a copy of the invoice.

Treasury Did Not Assess At Least $22,000 In Penalties

Our review of industrial sewer user accounts receivable revealed that Treasury did not assess at least 24 delinquent penalties totaling over $18,000 during the last three years. In addition, Treasury's Accounts Receivable system did not include an additional seven delinquent penalties totaling $3,800 that Treasury did not assess on a group of invoices for one customer during 1990-91. Table IV shows these penalties.

TABLE IV
SUMMARY OF DELINQUENT SEWER PENALTIES
TREASURY DID NOT ASSESS

YEAR	NUMBER OF PENALTIES NOT ASSESSED	TOTAL AMOUNT OF PENALTIES NOT ASSESSED
1990-91	7	$3,727.10
1995-96	2	5,210.40
1996-97	11	7,853.90
1997-98	11	5,070.90
TOTAL	31	$21,862.30

We provided Treasury with details for the items shown in Table IV. Treasury is investigating these items and will take appropriate corrective measures.

Treasury's New Automated Collection Management System

Treasury is in the final stages of issuing a contract for a new automated collection management system that should reduce staff's dependence on manual tracking systems. Installation of the system should be complete in 1998-99.

Recommendation #12

Treasury develop procedures to ensure that delinquent sewer penalties are imposed and collected. (Priority 2)

The FAM Is Out-Of-Date

According to the FAM, if collection efforts fail, Treasury should file a suit in Small Claims Court to collect delinquent invoices up to $2,500, and Treasury should refer invoices over $2,500 to the City Attorney for legal action. According to Treasury officials, Treasury uses a $5,000 limit for Small Claims Court actions. The FAM also specifies that at three-month intervals, the Treasury should purge its accounts receivable file of accounts that the Finance Department and/or the City Attorney's Office deems to be uncollectable. The FAM specifies that the Director of Finance must approve the writing-off of invoices with amounts $3,000 and under and the City Council must approve the writing-off of invoices with amounts exceeding $3,000. According to the Municipal Code, these write-off limits are $5,000. Thus, the FAM is out-of-date with regards to both the dollar limit for Small Claims Court and the dollar limits for approving writing-off uncollectable invoices.

Recommendation #13

Finance should update the FAM Section 4.1 to reflect current dollar limits on Small Claims Court actions, and current Municipal Code limits for approving writing-off uncollectable invoices. (Priority 3)

Treasury Has Not Collected Nearly $63,000 In Bills That Were Six Months Past Due

Our review of industrial sewer user accounts receivable revealed 24 invoices totaling nearly $63,000 that were more than six months overdue. Table V summarizes these invoices.

TABLE V
OUTSTANDING INDUSTRIAL SEWER USER ACCOUNTS RECEIVABLE MORE THAN SIX MONTHS OLD

	NUMBER OF INVOICES OUTSTANDING	OUTSTANDING BALANCES MORE THAN SIX MONTHS OLD
1990-91	8	$35,423.43
1996-97	9	10,816.80
1997-98	7	16,525.40
TOTAL	24	$62,765.63

In at least 14 of the 16 cases in 1996-97 and 1997-98, shown above, the delinquent amount was an outstanding 10 percent penalty amount. For example, the ESD billed one customer $10,722 on December 17, 1997. The bill was due 40 days later, on January 26, 1998. The customer paid the original bill of $10,722 on March 12, 1998, but did not pay the $1,072.20 penalty Treasury had assessed. As of June 1998, the customer had not paid the $1,072.20 penalty.

In our opinion, the lack of a formal delinquent penalty notice process contributes to customer nonpayment. Accordingly, Treasury should develop procedures to ensure that customers are notified of delinquent penalties and past due Sewer Bills and delinquent penalties are collected.

It should be noted that subsequent to our discussion with Treasury about these findings, Treasury has already collected more than $22,000 of the $63,000 that we identified.

Recommendation #14

Treasury file suit in Small Claims Court for past due Sewer Bills up to $5,000, refer to the City Attorney any past due Sewer Bills over $5,000, and write-off uncollectable Sewer Bills in accordance with the City's Administrative Manual. (Priority 2)

Recommendation #15:

Treasury develop formal procedures to ensure that customers are notified of delinquent penalties on Sewer Bills and to ensure that past due Sewer Bills and delinquent penalties are collected. (Priority 2)

CONCLUSION

Our review of industrial user accounts revealed at least 24 delinquent penalties totaling over $18,000 that Treasury did not assess during the last three years. In addition, we found nearly $63,000 in past due sewer charges that are more than six months overdue. In our opinion, Treasury should review its procedures to ensure that delinquent penalties are assessed, and write off outstanding amounts that have not been forwarded to the Attorney's Office for action.

RECOMMENDATIONS

We recommend that Treasury:

Recommendation #12

Develop procedures to ensure that delinquent sewer penalties are imposed and collected. (Priority 2)

Recommendation #13

Finance should update the FAM Section 4.1 to reflect current dollar limits on Small Claims Court actions, and current Municipal Code limits for approving writing-off uncollectable invoices. (Priority 3)

Recommendation #14

File suit in Small Claims Court for past due Sewer Bills up to $5,000, refer to the City Attorney any past due Sewer Bills over $5,000, and write-off uncollectable Sewer Bills in accordance with the City's Administrative Manual. (Priority 2)

Recommendation #15

Develop formal procedures to ensure that customers are notified of delinquent penalties on Sewer Bills and to ensure that past due Sewer Bills and delinquent penalties are collected. (Priority 2)

FINDING V

THE COUNTY HAS NOT REMITTED $26,000 IN SEWER AND STORM DRAIN FEES FOR 1996-97 AND 1997-98

The City of San Jose (City) collects most of its sewer and storm drain fees through the County of Santa Clara's (County) tax assessment rolls. Our review revealed that the County has not remitted $26,000 in sewer and storm drain fees for 1996-97 and 1997-98. In our opinion, the Finance Department should (1) actively pursue collection of these sewer fees and (2) annually reconcile billings to remittances and pursue any differences.

The County Collects Sewer Fees And Remits Them To The City

The Treasury Division (Treasury) of the City's Finance Department is responsible for calculating most sewer and storm drain bills, and transmitting billing information to the County. The County places these fees on its assessment rolls, bills property owners, collects the fees, and remits the fees to the City. The City pays the County a one percent administrative fee, or more than $730,000 per year, to handle these accounts.

During our review, we noted that the County had not remitted $16,000 in sewer and storm drain fees for 1996-97. The County did not provide any explanation for this difference. Subsequent to discussions between the Auditor and Treasury about this problem, the Director of Finance contacted the County regarding this discrepancy. Specifically, the Director asked for clarification of the adjustment amounts that the County showed on its remittance reports.

According to Treasury staff, the County has not remitted $10,000 in sewer fees for 1997-98, or provided any explanation or justification for this difference.

In our opinion, the Administration should initiate collection of prior sewer fees due from the County. Secondly, the Administration should annually reconcile sewer and storm drain billings to remittances and actively pursue any differences.

Recommendation #16

The Administration should initiate collection of any sewer and storm drain fees due from the County. (Priority 1)

Recommendation #17

The Administration should annually reconcile its sewer and storm drain billings to Santa Clara County remittances and pursue any differences. (Priority 2)

CONCLUSION

The County has not remitted $26,000 in 1996-97 and 1997-98 sewer and storm drain fees. In our opinion, the Finance Department should initiate collection of prior sewer and storm drain fees due from the County, and hereafter reconcile sewer and storm drain billings to County remittances and actively pursue any differences.

RECOMMENDATIONS

We recommend that the Finance Department:

Recommendation #16

Initiate collection of any sewer and storm drain fees due from the County. (Priority 2)

Recommendation #17

Annually reconcile its sewer and storm drain billings to Santa Clara County remittances and pursue any differences. (Priority 2)